No. 831 - 833

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

GUARANTY TRUST COMPANY OF NEW YORK, TRUSTEE, TRUSTEES OF UNION COLLEGE IN THE TOWN OF SCHENECTADY, STATE OF NEW YORK, FRANK BAILEY, MARIE LOUISE BAILEY, MARIE LOUISE BAILEY AND FRANK BAILEY AS TRUSTEES, JOHN VANNECK AND PAUL C. MORAN AS TRUSTEES AND EQUITABLE HOLDING CORPORATION

Petitioners

v.

STANDARD GAS AND ELECTRIC COMPANY
(And Other Cases as Shown on Page 1)

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT, STANDARD GAS AND ELECTRIC COMPANY, IN OPPOSITION

THE TWENTIETH CENTURY PRESS, INC., CHICAGO

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Petitioners

v.

SECURITIES AND EXCHANGE COMMISSION

Respondent

(Number 8885 below)

SAME

v.

STANDARD GAS AND ELECTRIC COMPANY AND SECURITIES AND EXCHANGE COMMISSION

Respondents

(Number 8906 below)

SAME

v.

STANDARD GAS AND ELECTRIC COMPANY

Respondent

(Number 8934 below)

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT, STANDARD GAS AND ELECTRIC COMPANY, IN OPPOSITION

Opinions Below

The opinion of the Circuit Court of Appeals (R. 203) is reported in 151 F. 2d 326. The opinion of the District Court (R. 129a) is reported in 59 F. Supp. 274. The opinions of the Securities and Exchange Commission[1] are reported in Holding Company Act Release No. 5430 (R. 3a) and Holding Company Act Release No. 5070 (R. 29a).

Jurisdiction

The judgments of the Circuit Court of Appeals were entered on September 14, 1945. The Petition for Writs of Certiorari was filed on February 11, 1946. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. Section 347).

Questions Presented

1. Whether Respondent,[2] a solvent registered holding company, could provide in a Plan for Recapitalization,[3] pursuant to Section 11(e) of the Public Utility Holding Company Act of 1935,[4] for the payment of its notes and debentures partly in cash and partly in stocks of other corporations, rather than entirely in cash.

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[1] Hereinafter referred to as "the Commission."
[2] Standard Gas and Electric Company, hereinafter referred to as "Respondent."
[3] Hereinafter referred to as "the Plan."
[4] Hereinafter referred to as "the Act" (15 U. S. C. 79).

2. Whether the Plan providing for the payment of notes and debentures in cash and in such stocks was fair and equitable.

3. Whether the Plan, which was filed in compliance with the mandatory provisions of the Act and which provides for immediate payment of notes and debentures not due by their terms until some years later, must provide for payment of the call premiums specified in the applicable trust indentures.

4. Whether Section 11 of the Act as construed by the Commission in the instant case is constitutional.

Statute Involved

The pertinent provisions of Section 11 of the Public Utility Holding Company Act of 1935 (15 U. S. C., Sec. 79k *et seq.*) are set forth in the annexed Appendix A.

Additional Statement

The Findings and Opinion of the Commission

The Commission found (R. 90a) that the Plan would go "a long way" in the direction of limiting the operations of Respondent to the Philadelphia Company system, and was necessary to effectuate the provisions of Section 11 (b)(1) and 11(b)(2). (R. 94a). It held the Plan to be fair and equitable in its treatment of note and debenture holders (R. 97a). The highest coverage by Respondent of its fixed charges between 1936 and 1944 on a corporate basis was 1.46 times (in 1943), and on a consolidated basis the highest coverage for those fixed charges and for prior charges of subsidiaries, was 1.25 times (for the twelve months ended June 30, 1944) (R. 95a). For the $695.05 principal amount of each $1000 note and debenture to be discharged under

the Plan through the distribution of Respondent's portfolio securities, the holders thereof would receive common stocks which were paying $43.30 in dividends annually, earned $59.03 in 1943 and had estimated future annual earnings of $69.63 (R. 93a). These figures are to be compared with the interest, $41.70, that would be due to the holders on the $695.05. The Commission considered the securities to be delivered to have a slightly higher market value than the aggregate basic value of $695.05 assigned under the Plan (R. 96a).

The Commission held that the holders of the debentures (the notes being callable, by their terms, without any premium) were not entitled to receive call premiums because their retirement was "plainly necessitated by Section 11" (R. 94a); that not only was Respondent required to divest itself of portfolio securities and contract its capital structure in order to conform with Section 11(b)(1), but it must simplify its corporate structure and bring about an equitable distribution of voting power required by Section 11(b)(2). (R. 94a).

Proceedings in the District Court

After the Circuit Court of Appeals for the Third Circuit reversed the judgment of the District Court for the District of Delaware and issued its mandate, the District Court, for the reasons stated in its opinion (Appendix B, p. 21), remanded the proceedings to the Commission and divested itself of jurisdiction, subject to the right of the Commission to make application for reinstatement of its original petition. The Order and Decree of that Court, dated December 29, 1945, contained the following findings of fact:

> "6. The value of the shares of stock to be delivered to the Noteholders[5] under the provisions of the

[5] The District Court referred to the notes and debentures as "the Notes."

Amended Plan has increased to such an extent since the Amended Plan was approved by the Commission on November 15, 1944, and since the entry by this Court on March 29, 1945, of a decree making certain Findings of Fact and Conclusions of Law relative to the Amended Plan, that it may require a re-examination of the Amended Plan to test whether it is fair and equitable to the persons affected thereby.

"7. Evidence submitted in the form of affidavits and offers of proof, in the form of admissions of counsel, and in the form of facts, of which the Court was requested to and did take judicial notice, indicates that the portion of the portfolio securities of Standard, proposed in the Plan to be distributed to the Noteholders in partial discharge of their claims, have a current actual and market value substantially in excess of that part of the claims of the Noteholders to be discharged thereby. Estimates of the amount of such excess vary between a minimum of $12,250,000.00 and a maximum of $30,000,000.00."

Respondent is presently doing everything possible to effect a program contemplating the orderly and expeditious retirement of all its outstanding notes and debentures. The time during which Respondent may call such notes and debentures was extended to March 20, 1946 by order of the Commission entered February 18, 1946. A group of banks has agreed to loan Respondent $51,000,000 to be used, with a part of its treasury cash, for the redemption of all of its outstanding notes and debentures, and on February 26, 1946, an order was entered by the Commission authorizing the issuance by Respondent of its 2½% secured promissory notes, in the aggregate principal amount of $51,000,000, to evidence the loan.

Reasons for Denying the Writs

Since the District Court has remanded the Plan to the Commission and has specifically upheld Respondent's right

to redeem its notes and debentures at par, plus the call premiums on the debentures provided in the applicable trust indentures, and since Respondent is presently proceeding with the arrangements contemplating the call for redemption, it might well be that all the questions presented in the petition are moot.

In the event the Court determines that the issues raised by Petitioners are not moot, Respondent submits that the petition should nevertheless be denied for the following reasons:

The language of Section 11 of the Act, and the opinion of this Court in *Otis & Company* v. *Securities & Exchange Commission,* 323 U. S. 624, leave no doubt that Section 11 is intended to authorize and direct the recapitalization of registered public utility holding companies to conform with the standards provided in the Act. Creditors' rights as well as all other contract rights may be revised in accordance with the principles of fairness and equity as defined by this Court. It is sufficient that they be given compensatory treatment and receive the equitable equivalent of their claims.

The Plan recognizes and satisfies in full the contract rights of note and debenture holders.

The Courts below which have passed on the issue agree that creditors are not entitled to call premiums, and the principles of law expressed in their opinions have been approved by this Court in the *Otis* case, *supra.*

Congress' right to regulate interstate commerce fully sustains the constitutionality of Section 11 in its instant application.

Argument

1. Section 11(e) of the Act authorizes the submission of plans by a registered holding company "for the divestment of control, securities or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of sub-section (b)". Section 11(b)(1) authorizes the Commission to "take such action as the Commission shall find necessary to limit the operations of the holding company system • • • to a single integrated public-utility system" and, subject to certain conditions and in the discretion of the Commission, one or more additional integrated public-utility systems. Section 11(b)(2) authorizes the Commission to require any registered holding company to "take such steps as the Commission shall find necessary to insure that the corporate structure or continuing existence of any company in the holding company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders."

The term "corporate structure" as employed in the Act has been interpreted and applied by the Courts as synonomous with "security structure" and as including outstanding debt.

> *In re Laclede Gas Light Co.* et al., 57 F. Supp. 997;
> *In re American Gas & Power Co.*, 55 F. Supp. 756;
> *In re Consolidated Electric & Gas Co.*, 55 F. Supp. 211;
>
> *Jacksonville Gas Company*, H. C. A. Release Nos. 3570 and 3572; approved 46 F. Supp. 852 (D. C. S. D. Fla.);
>
> *In re Community Power & Light Company*, 6 S. E. C. 182; approved 33 F. Supp. 901 (D. C. S. D. N. Y.).

It is no longer open to question that Section 11 authorizes the Commission to recapitalize registered holding com-

panies and to modify the contract rights of its security holders, including its creditors.

Otis & Co. v. *Securities and Exchange Commission*, 323 U. S. 624;

Commonwealth and Southern Corp. v. *Securities & Exchange Commission*, 134 F. 2d 747 (C. C. A. 3rd);

City National Bank & Trust Co. of Chicago v. *Securities & Exchange Commission*, 134 F. 2d 65 (C. C. A. 7th);

New York Trust Co. et al. v. *Securities & Exchange Commission*, 131 F. 2d 274 (C. C. A. 2d), cert. den. 318 U. S. 786;

In Re Jacksonville Gas Co. et al., 46 F. Supp. 852 (D. C. S. D. Fla.);

In re Community Power & Light Co., 33 F. Supp. 901 (D. C. S. D. N. Y.).

The Circuit Court of Appeals for the Third Circuit in approving (R. 203) the right of Respondent to satisfy the claims of note and debenture holders through the distribution of portfolio securities, reviewed the legislative history of Section 11 and demonstrated that it was the intention of Congress to authorize the Commission to direct corporate recapitalization when it deemed such recapitalization necessary to carry out the requirements of integration and simplification provided in the Act, and the satisfaction of creditors' claims through the issuance of other securities.

The Act suggests no distinction between creditors' rights and the rights of other classes of security holders; nor is there anything inherent in the character of a note or debenture so that it can successfully be maintained that the contract of a note or debenture holder is so different from

the contract of a preferred stockholder that the rights of a preferred stockholder may be varied, but those of a creditor must remain inviolate.

The alleged ability of Respondent to pay its debts in cash would not necessitate such payment. The Act provides that the Court must approve a plan if it finds that the plan is "fair and equitable" and "appropriate to effectuate the provisions of this Section" [Section 11(e)]. The Court is not required to make a finding of necessity in the sense suggested by Petitioners, or in any other sense. The question of the type of plan most appropriate to carry out the provisions of Section 11(b) is a matter for the Commission and not for the Courts. Whether or not Respondent could or should have sold the securities to be distributed to note and debenture holders was a question of fact to be determined by the Commission.

> *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railway Co.*, 318 U. S. 523, 544;
>
> *New York Trust Co.* v. *Securities & Exchange Commission*, 131 F. 2d 274, 275 (C. C. A. 2d), cert. den. 318 U. S. 786.

The word "necessary" as employed in Section 11(e) does not mean that the Plan must be the sole means of effectuating the purposes of Section 11(b).

> *In re Jacksonville Gas Company* (1942), H. C. A. Release Nos. 3570 and 3572; approved 46 F. Supp. 852 (D. C. S. D. Fla.);
>
> *Columbia Oil & Gas Corporation* (1942), H. C. A. Release No. 3885; affirmed *sub nom.* L. J. Marquis & Co. et al. v. Securities and Exchange Commission, 134 F. 2d 822 (C. C. A. 3rd);

In Re The United Light and Power Co. (1943) H. C. A. Release No. 4215; approved 51 F. Supp. 217 (D. C. D. Del.); affirmed *sub nom.* In re Securities and Exchange Commission, 142 F. 2d 411 (C. C. A. 3rd); affirmed, *sub nom.* Otis & Co. v. Securities and Exchange Commission, 323 U. S. 624.

As was said by this Court in *McCullough* v. *Maryland*, 4 Wheat. 316, 413-414 (1819):

> "To employ the means necessary to an end, is generally understood as employing any means calculated to produce the end, and not as being confined to those single means, without which the end would be entirely unattainable."

The distribution of common stocks under Respondent's Plan conformed with

(a) The policy expressed in the Act of simplifying the holding company system of Respondent, and eliminating from that system properties deemed by the Commission unsuitable for retention;

(b) The order entered by the Commission under the mandatory provisions of the Act requiring the disposal by Respondent of all securities of corporations owned by it other than those of Philadelphia Company and Public Utility Engineering and Service Corporation; and

(c) The simplification of the corporate structure of Respondent through (a) the elimination of six issues of notes and debentures with varying terms, (b) the elimination of its four classes or series of stock with almost one-half the voting power with respect to directors lodged in a class of stock held by the Commission to be without value, and (c)

the creation of a simple corporate structure of one short term loan and one class of stock.

2. The action of the Commission in approving the Plan as fair and equitable, and necessary and appropriate to effectuate the provisions of Subsection (b) of Section 11 of the Act, is forcibly attacked by Petitioners. But their position is neither tenable nor formidable when considered in the light of the decisions interpreting the pertinent sections of the Act.

The Courts have held that the statutory standard "fair and equitable," whether in reorganizations, in bankruptcy, or in compliance with regulatory statutes, means that each class of security holders must receive compensatory treatment before payment to any junior class. They have also stated that this rule does not mean security holders must retain their priorities or receive cash. It is sufficient that they receive the "equitable equivalent" of their holdings. The "equitable equivalent" of a security may be other securities of a different character provided compensation is afforded for loss of rights. *Kansas City Terminal R. Co., et al.*, v. *Central Union Trust Co. of N. Y.*, 271 U. S. 445; *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510; *Ecker, et al.*, v. *Western Pacific Railroad Corporation*, 318 U. S. 448; *Group of Institutional Investors and Mutual Savings Bank Group* v. *Chicago, Milwaukee, St. Paul & Pacific R. R. Co., et al.*, 318 U. S. 523.

The Commission and the Circuit Court of Appeals found that the cash and portfolio securities to be distributed under the Plan to owners of notes and debentures were the "equitable equivalents" of the rights surrendered, and consequently fell squarely within the rules enunciated above. It is fundamental law that the findings of the Commission

will not be disturbed in the absence of an abuse of its powers.[6]

This Court has recognized that a mathematical calculation need not be made to determine the precise value of priorities and contract rights. The standard applied is the broad ideal of ethical business treatment. *Securities and Exchange Commission* v. *Chenery Corporation*, 318 U. S. 80; *Group of Institutional Investors and Mutual Savings Bank Group* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co., et al.*, 318 U. S. 523. The flexibility of the rule is manifest from the following statement by this Court in *Otis & Co.* v. *Securities and Exchange Commission*, 323 U. S. 624:

> "The allocation properly may be made without dollar valuation so long as 'each security holder in the order of his priority receives from that which is available for the satisfaction of his claim the equitable equivalent of the rights surrendered'."

3. (a) The claim of Petitioners that call premiums should be paid on the debentures if the Plan is effectuated is contrary to the authorities on this point. The Commission, the District Court and the Circuit Court of Appeals have disagreed with this contention. It is respectfully submitted that the correct rule of law is that the retirement of debentures pursuant to a Plan of a solvent public utility holding company under the Act is not a "voluntary calling" by the issuing corporation so as to entitle the holders of said securities to the call premiums specified in

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[6] *New York Trust Co.* v. *Securities and Exchange Commission*, 131 F. 2d 224, certiorari denied, 318 U. S. 786; *Securities and Exchange Commission* v. *Chenery Corporation*, 318 U. S. 80; *Group of Institutional Investors and Mutual Savings Bank Group, Petitioners*, v. *Chicago, Milwaukee, St. Paul & Pacific R. R. Co., et al.*, 318 U. S. 523.

their contracts between that corporation and its security holders. *New York Trust Co.* v. *Securities and Exchange Commission,* 131 F. 2d 274 (C. C. A. 2), cert. den. 318 U. S. 786, rehearing denied 319 U. S. 781; *City National Bank and Trust Co.* v. *Securities and Exchange Commission,* 134 F. 2d 65 (C. C. A. 7); *In re Laclede Gas Light Co.,* 57 F. Supp. 997, (D. C. E. D. Mo.); *In re Consolidated Electric and Gas Co.,* 55 F. Supp. 211 (D. C. D. Del.). It is significant that Petitioners have cited no authority in support of their position.

(b) It is well settled that it is not necessary that a Plan under the Act provide for the payment of additional compensation to the owners of notes and debentures which are being satisfied or discharged under said Plan for the discontinuance of interest payments on said securities so long as said owners receive the "equitable equivalent" of the rights they surrender. *Otis & Co.* v. *Securities and Exchange Commission,* 323 U. S. 624; *Group of Institutional Investors and Mutual Savings Bank Group* v. *Chicago, Milwaukee, St. Paul and Pacific Railroad Co., et al.,* 318 U. S. 523.

4. The Plan compensates note and debenture holders for their claims in their entirety. Voluminous testimony was taken before the Commission and findings of fairness and equity were made in accordance with the standards laid down by this Court. It cannot therefore seriously be maintained that an "appraisal method" was employed to evaluate creditors' rights, nor can it be suggested that valuable property rights were destroyed without just compensation. The provision of the Fifth Amendment of the Federal Constitution that property shall not be taken for public use without just compensation applies only to direct appropriations. Legal tender cases, *Knox* v. *Lee* (*Parker* v. *Davis*), 12 Wall. 457, 551; *Henderson* v. *Bryan,*

46 F. Supp. 682, 685 (D. C. S. D. Cal.); *In Re Community Power & Light Co.*, 33 F. Supp. 901 (D. C. S. D. N. Y.).

The right of Congress in regulating interstate commerce to require the equitable adjustment of creditors' rights so long as they receive full compensatory treatment is no longer open to question.

> *Group of Institutional Investors* v. *Chicago M. & St. P. R. Co.*, 318 U. S. 523;
>
> *Consolidated Rock Products Co.* v. *Dubois*, 312 U. S. 510;
>
> *Continental Ill. N. B. & T. Co.* v. *Chicago R. I. & P. R. Co.*, 294 U. S. 648;
>
> *Highland* v. *Russell Car & Snow Plow Co.*, 279 U. S. 253;
>
> *Kansas City Terminal R. Co.* v. *Central Union Trust Co.*, 271 U. S. 445;
>
> *Continental Insurance Co.* v. *United States*, 259 U. S. 156.

In *Continental Ill. Nat. Bank & Trust Co.* v. *Chicago Rock Island & P. R. Co.*, 294 U. S. 648, 680, this Court stated:

> "Speaking generally, it may be said that Congress, while without power to impair the obligation of contracts by laws acting directly and independently to that end, undeniably, has authority to pass legislation pertinent to any of the powers conferred by the Constitution however it may operate collaterally or incidentally to impair or destroy the obligation of private contracts."

The power to vary creditors' claims in the course of regulating interstate commerce was specifically upheld in

Continental Insurance Company v. *United States,* 259 U. S. 156, 171:

> "The power of the court under the Sherman Anti-trust Law to disregard the letter and legal effect of the bonds and general mortgage under the circumstances of this case, in order to achieve the purpose of the law, we cannot question. The principles laid down and followed in the case of *United States* v. *Southern P. Co.* decided today [259 U. S. 214, post, 907, 42 Sup. Ct. Rep. 496], leave no doubt upon this point. Indeed, the case which we there cite, *Philadelphia, B. & W. R. Co.* v. *Schubert,* 224 U. S. 603, 613, 614, 56 L. ed. 911, 916, 917, 32 Sup. Ct. Rep. 589, 1 N. C. C. A. 892, is a stronger instance of the power of Congress, in regulating interstate commerce, to disregard contracts, than is needed in this case, because there it was enforced as to a contract made before the regulation."

Conclusion

All of the questions involved, as presented by Petitioners, have been decided by this Court. They present no new or novel departure from settled law, and we respectfully submit that the petition for writs of certiorari should be denied.

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